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¶1. (SBU) Summary: With elections looming in December, Kenya's private sector and reform-minded government officials are racing to either complete or put in motion a series of intertwined reforms and infrastructure projects aimed at generating growth across the entire economy through greater competition, lower costs, and greater investment in the cross-cutting sector known as information and communication technologies (ICT). If all of the reform and infrastructure initiatives now in play converge in the coming months, they could set the stage for stronger sustained economic growth throughout Kenya and the region for years to come. Among the highlights:

-- The privatization (and revitalization) of Telkom Kenya, the country's monopoly fixed line phone company. Likely buyer: A consortium led by France Telecom. (Paras 3-4).

-- The sale to the public of 25% of Safaricom, the country's (and the region's) largest and most profitable mobile phone company. (Paras 5-7).

-- The issuance of Kenya's first 3G mobile license, worth a cool $25 million. (Para 8).

-- Greater competition in the mobile market with the licensing of a third mobile service provider and a new "fixed wireless" service using CDMA technology. (Paras 9-11).

-- Significant progress towards achieving the holy grail of fiber optic connectivity with the rest of the world. One or two submarine fiber optic cables, one led by Kenya, and one by a U.S. venture capital firm, should be "lit up" and in business by mid-2009. (Paras 14-18).

-- Significant progress towards a terrestrial fiber network in Kenya that will go to the borders of all its neighbors. This, together with the submarine cables, should provide affordable, high-speed global connectivity to the entire EAC region. (Paras 19-20).

End summary.

¶2. (U) This cable is an update on activities and developments in Kenya's critical ICT sector. It is based on a wide range of sources and information gathered in recent weeks, including from meetings on October 18 between Emboffs, a visiting U.S. International Trade Commission analyst, and several key players in Kenya's ICT sector.

The End Game: Privatizing Telkom Kenya

¶3. (SBU) After years of struggle and self-imposed setbacks, Kenya is finally on the verge of privatizing its lumbering, loss-making monopoly fixed line phone company, Telkom Kenya. With advice from the World Bank Group's International Finance Corporation (IFC) and $80 million from the World Bank itself, Telkom has peacefully shed over 10,000 jobs in the past 12 months, and is scheduled for a final tranche of job cuts in November that will bring its payroll to just over 3,000. The estimated savings from these job cuts will total over KSh 4 billion (over $60 million) per year, freeing up capital badly needed to upgrade both Telkom's fixed network, and expand its more recently established "fixed" mobile network (see para 11 below).

French, Indians, Brits, Libyans in Hunt to Buy Telkom

¶4. (SBU) Telkom is restructuring its balance sheet to reduce the KSh 50 billion ($760 million) in debt and tax liabilities it now carries on its books using the proceeds of the upcoming sale of Safaricom, the mobile company in which it holds a 60% share (para 5). The company's privatization plan calls for the sale of 51% of the company to a strategic investor, with the winner to be announced on November 26. Details at this stage are sketchy, but according to Telkom CEO Sammy Kirui on October 18, there are six consortia

currently bidding for the purchase. These include three Indian-led groups: Reliance, MTNL, and Bharti. Another group brings together British Telecom and a Libyan entity we believe is called LAP - the Libya Africa project. France Telecom and Agility of Kuwait may form a fifth group, and Telkom South Africa leads a sixth. Bitange Ndemo, Permanent Secretary in the Ministry of Information and Communication, told Econ/C October 23 that the France Telecom/Agility consortia is the most aggressive thus far in bidding for Telkom.

To Privatize Telkom, You Have to Spin Off Safaricom

¶5. (SBU) Job cuts aside, the most challenging aspect of the Telkom Kenya privatization has stemmed from the company's ownership, on behalf of the GOK, of 60% of Safaricom, Kenya's first and largest mobile phone service provider (see below). In an anomaly that is galling to Safaricom's management and foreign owners, Telkom is already offering its own mobile services in direct competition with Safaricom and with the country's second mobile provider, Celtel (more on this below in paras 11-13).

Why the Safaricom IPO is Important

¶6. (SBU) To resolve this glaring conflict of interest, the GOK is moving to unbundle the two companies through what will be the largest (by far) initial public offering (IPO) in the history of the Nairobi Stock Exchange (NSE). The GOK plan calls for Telkom's 60% ownership in Safaricom to be transferred to the Ministry of Finance in the coming days so that the privatization can proceed. Then, either late this year or early next, 25% of Safaricom's shares will be sold to the public on the NSE. The GOK will retain the balance of shares, but will place a portion of these in a special purpose vehicle designed to allow Safaricom's 40% owner, Vodaphone Kenya (which is a subsidiary of Vodaphone UK), to buy additional shares in

the future and ultimately achieve 51% or more ownership of Safaricom -- should it so choose. Recent press reports, however, indicate Vodaphone may forgo a majority stake in Safaricom if the GOK cedes its right as the current majority shareholder to appoint the company's CEO.

¶7. (SBU) Meanwhile, the IPO, if successful, will represent a triple play for Kenya. Ministry PermSec Ndemo believes the IPO will raise around $2 billion. This will provide direct one-time support of $530 million to plug the GOK's budget deficit. It will also allow the GOK to pay down Telkom Kenya's debt and tax liabilities and pay for a new mobile license (see para 13), all in preparation for its privatization. In addition to unlocking the Telkom privatization in this way, the Safaricom IPO is also important because it is likely to play a major role in the ongoing cultural shift in Kenya away from traditional assets like land and cattle to more modern financial instruments like stocks and bonds.

Mobile Market Also on Fire

¶8. (SBU) As in many other African markets, the growth of mobile telephony in Kenya continues to astound. In 2000, industry pundits estimated that the country would have 400,000 users within five years, but Kenya now has 8.1 million after seven. Safaricom CEO Michael Joseph, whose company's pre-tax profits in 2006 equaled 1.6% of Kenyan GDP, said on October 18 that Safaricom is enjoying 50% revenue growth per year. The Safaricom and Celtel networks currently cover 30% of Kenya's land area and 75-80% of the population. With a penetration rate of only 25%, however, the market looks set to continue its rapid growth over the next 5-10 years. A telling example: Safaricom on October 18 paid $25 million to the industry regulator, the Communications Commission of Kenya (CCK), for a Third Generation, or 3G, mobile license. CEO Michael Joseph said the company needs 3G spectrum to keep up with demand for high-speed data services from corporates, and because Kenya is running out of room on the 2G radio spectrum.

Econet Finally Gets 3rd Mobile License

¶9. (SBU) But the current mobile market, dominated by Safaricom and Celtel, has come to resemble just that - a duopoly, resulting in a less-than-fully competitive market. It was thus good news in August when Econet Wireless, a South Africa-based mobile phone operator, was finally allowed to exercise its rights under a much-coveted third mobile license, which it had won in a tender three years earlier in September 2004. It had been blocked from rolling out its network by then-Minister of Information and Communications (and current Foreign Minister) Raphael Tuju. Tuju attempted to revoke the license, citing unexplained irregularities in the tender process. Econet fought Tuju and the Communications Commission of Kenya (CCK) in court, and won, but was still prevented by the CCK from rolling out its network because it had not paid fully for the license fee after a falling out with its local partner.

¶10. (SBU) In July, Econet, the Ministry, and CCK reached two interlocking agreements in which Econet agreed to drop several pending lawsuits against Tuju and the GOK in exchange for the Ministry declaring Econet's license to be "in good standing." CCK in turn agreed to provide Econet with the network codes and frequencies required for roll-out as soon as Econet satisfied the requirement for 30% local Kenyan ownership, and paid the $12 million it still owed on the license fee. CCK Director-General John Waweru confirmed on October 18 that Econet has met these requirements. As such, Econet expects to begin service roll-out by March 2008 after an initial investment in infrastructure totaling $100 million.

More Competition: Telkom Kenya Enters Mobile Fray...

¶11. (SBU) As noted above, Telkom Kenya, although ostensibly a fixed line service provider, is also in practice the other new player in Kenya's mobile market. In September, it officially rolled out a "fixed wireless" service following a year-long trial period. The service, which is based on Code Division Multiple Access (CDMA) technology, came to Telkom as a gift from the Chinese government in the form of a KSh20 million ($300,000) concessional credit to Kenya in 2006, ostensibly to fund a CDMA network that would reach under-served rural areas with nominally fixed services. In September 2006, Telkom and Chinese firm Huawei signed a contract to construct a CDMA 2000 access network and microwave backbone, and to provide thousands of free CDMA handsets (which Kenyan middlemen promptly bought up, marked up, and sold). Since last year when the trial began, Telkom has aggressively rolled out the service in urban areas, competing head-to-head with Safaricom and Celtel. It already claims 150,000 subscribers, and predicts it will have a million customers by the end of the year. Indeed, having failed through the years to expand its legacy fixed line network, Telkom is banking on "Telkom Wireless" to make it commercially relevant after its privatization.

...But Is It Fair?

¶12. (SBU) Safaricom and Celtel point out that Telkom Wireless amounts to a gift from the GOK to Telkom to make the latter more attractive to a prospective buyer - and at their expense in terms of competitive fairness. They argue that the CDMA network was originally cast as a GOK development project to provide fixed services to remote rural communities, but has now morphed into a full-scale commercial mobile service. Further, they rightly point out that Telkom Kenya is not properly licensed for mobile services, did not pay for a mobile license, and gets an additional edge over Safaricom and Celtel by not having to pay the 10% excise duty on mobile airtime that they do.

Telkom to Get Mobile License for $55 Million

¶13. (SBU) In response to these criticisms, the CCK on September 28 published a notice of its intention to issue a mobile license to Telkom Kenya. In separate meetings on October 18, CCK Director General John Waweru and Telkom Kenya CEO Sammy Kirui both insisted that Telkom Kenya would pay for the license at a price of $55 million, equivalent to the price paid by Safaricom in 2000. Despite this pledge, industry players remain suspicious of GOK and CCK intentions, believing the latter will continue to tilt the competitive playing field in favor of Telkom Kenya. These fears are

fueled by persistent rumors that two major GOK-initiated infrastructure projects, an undersea fiber optic cable and a new terrestrial fiber network (paras 14-18 below), will be handed over to Telkom Kenya for management once they are completed. This would give Telkom effective control over vital infrastructure that all companies, including its rivals, will need to survive and grow.

The Desperate Need for Fiber...

¶14. (SBU) As noted reftels, Africa's East Coast is the last remaining major landmass in the world without fiber optic connectivity to the rest of the world. As such, all data and voice traffic in and out of the region must utilize satellite technology, which is both expensive and inappropriate for certain types of ICT applications. The growth of the ICT sector in Kenya, and with it the entire economy, has lagged as a result. Kenya's fledgling call center industry, for example, is currently paying $3,000 per megabyte per month vs. the global norm of $300-600 in competing markets such as India's. Moreover, satellite bandwidth is increasingly scarce at any price. According to Safaricom CEO Michael Joseph on October 18, Kenya will run out of satellite capacity in July 2008, forcing companies to pay higher costs for

increasingly lower quality satellite bandwidth. Safaricom - indeed the entire region - is desperate for affordable fiber connectivity.

...Under the Sea...

¶15. (SBU) A number of projects are underway to deal with this critical infrastructure bottleneck. Reftels report extensively on three different competing initiatives to construct a submarine fiber optic cable for the East Coast of Africa. Of the three, the two front runners continue to be the Kenya-UAE TEAMS project, which will connect Mombasa with Fujaira in the UAE, and the larger SEACOM project, which will run along the entire coastline from South Africa to the Red Sea. It is led by a subsidiary of American venture equity giant, the Blackstone Group.

¶16. (SBU) On October 11, TEAMS took a step closer to fruition when the GOK announced that French firm Alcatel had won the $82 million contract for system construction. In winning the tender, Alcatel edged out U.S. firm Tyco, which was unable to match its rival on either price or completion date, despite aggressive advocacy by the U.S. Mission in Kenya with both the company and the Ministry f Information and Communications. Alcatel has promised to complete the TEAMS cable by June 2009, but many suspect this date will slip. The CEOs of both Safaricom and Telkom Kenya complained on October 18 that the financing for the project has not yet been secured. They and other operators in Kenya and the region are being invited to make $5 million equity commitments to TEAMS by the end of November, but have yet to see a business plan for the project.

¶17. (SBU) SEACOM, meanwhile, also appears on track for completion by mid-2009, despite a great deal of uncertainty generated in September when South African Communications Minister Ivy Matsepe-Casaburri and other telecom officials stated publicly that the country would not allow non-South African-owned cables to land there. While these threats appear to have died down, the South African Government is the driving force behind a grandiose, almost utopian plan under the New Partnership for Africa's Development (NEPAD) to develop a continental terrestrial broadband network linked to several new submarine cables, all of which would be licensed by NEPAD (vs. national governments) and supervised by a new supranational regulator. The plan is outlined in the "Policy and Regulatory Framework Protocol for NEPAD ICT Broadband Infrastructure Network," completed in Kigali in August 2006. But only a handful of African countries have signed it. Kenya has not, and CCK Director-General Waweru said on October 18 that Kenya fundamentally disagrees with the approach being taken by the NEPAD protocol.

¶18. (SBU) In any event, in the teeth of these developments, SEACOM is proceeding with system construction, having already secured financing for the $300 million project and locked in a construction contract with U.S. fiber maker Tyco. In South Africa, it is partnered with Neotel, through whose license it will land near Durban. In Kenya, SEACOM is on the verge of having its landing rights in Mombasa approved by CCK.

...and on Land

¶19. (SBU) On land, at least two privately operated fiber networks already link a handful of major cities in Kenya. Electricity distributor Kenya Power and Lighting is also laying fiber optic cable on its poles and plans to offer bandwidth services. Additionally, Telkom Kenya completed a 310 mile fiber cable linking Mombasa to Nairobi in July 2006, and the company is just now completing the project's second phase - a cable linking Nairobi to the Ugandan border at Malaba. To complement this, the GOK in February announced an ambitious plan to build a $50 million national fiber network linking all of the country's major towns and cities. To manage the network, it formed a special purpose vehicle, the Fiber Optic National Network (FONN), owned by the Kenyan Ministry of Finance. In June, the GOK awarded the tender to construct FONN to

three different companies, Sagem of France and Huawai and ZTE of China. Three companies were chosen instead of one in order to finish the project more quickly, perhaps in as few as 6-7 months.

The Regional Implications

¶20. (SBU) Telkom Kenya's and private sector fiber already connects Nairobi to the Ugandan border. On top of this, the terrestrial FONN project will extend to Busia, also on the Ugandan border; Moyale on the Ethiopian border; Lokichogio near the border with Southern Sudan; and Namanga and Mabayani on the Tanzanian border. To further regionalize the effort, Kenya has offered equity ownership in TEAMS to telecom operators in the four other EAC countries, as noted in para 16 above. However, PermSec Ndemo told Econ/C October 23 that operators and governments in the four other EAC countries are "dragging their feet," and have been unwilling to commit to TEAMS for fear of irritating the South African government, which continues to push the grandiose NEPAD network initiative. Ndemo, a former U.S.-based business executive, sees the NEPAD plan as hopelessly unrealistic and many years away from realization. He said EAC country operators have until the end of November to commit to TEAMS. If they don't, they'll have to buy capacity from TEAMS at higher rates than they'd enjoy as owners. His view: NEPAD is a pipedream, TEAMS is coming soon, and EAC operators should get on board now before the train leaves the station.

Comment: Kenya in the Lead

¶21. (SBU) In any event, once both FONN is complete and either TEAMS and/or SEACOM land in Mombasa, a regional fiber network will be in place. Thereafter, and assuming a reasonable regulatory environment, the entire EAC region should benefit from affordable high-speed connectivity with itself, and with the rest of the world. As such, the importance of current ICT activities, policies, and trends in Kenya cannot be overstated. Whether its neighbors agree or not, Kenya in our view rightly sees itself as a leader in this regard. While its own regulatory environment still needs improvement, its policymakers have taken a great deal of political and economic risk over the past two years to get Kenya and the rest of region connected as quickly as possible to the rest of an increasingly "flat" and competitive global economy.
Slutz